



Signed: March 17, 2008

*Leslie Tchaikovsky*

LESLIE TCHAIKOVSKY  
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF CALIFORNIA

In re

No. 06-40277 TG  
Chapter 13

MICHAEL S. JOHNSON, CINDY  
CHOI JOHNSON,

Debtors.

**MEMORANDUM AND ORDER VACATING CONFIRMATION ORDER  
AND DISMISSING CASE WITH PREJUDICE**

The Court previously found, in a related adversary proceeding, that the above-captioned debtors had obtained confirmation of their chapter 13 plan through a fraud on the Court and vacated the confirmation order. Thereafter, it issued an order to show cause (the "OSC") why the case should not be dismissed with prejudice on this account. In response to the OSC, the debtors filed a memorandum attempting to persuade the Court that dismissal with prejudice was not appropriate. The Court finds the arguments made therein unpersuasive. The history of the case and the reasons for the Court's decision are set forth below.

The debtors filed a voluntary chapter 7 petition on March 8, 2006 and converted their case to chapter 13 on March 26, 2006. They

1 filed their schedules of assets and liabilities (the "Schedules") and  
2 Statement of Financial Affairs ("SOFA") on March 23, 2006. In their  
3 Schedules, they listed approximately \$539,000 of secured debt and  
4 \$168,000 in general unsecured debt. Hsiu Lin Yeh ("Yeh") was not  
5 listed as a creditor.

6 The debtors filed a chapter 13 plan April 5, 2006 and a third  
7 amended plan on August 18, 2006 (the "Plan"). On September 23, 2006,  
8 Yeh was added as a unsecured creditor with a disputed claim in the  
9 amount of \$9,100. On or about December 23, 2006, Yeh filed a proof  
10 of claim in the debtors' bankruptcy case in the amount of \$612,457.  
11 On or about January 9, 2007, the chapter 13 trustee (the "Trustee")  
12 filed an objection to Yeh's claim as untimely, in which the debtors  
13 joined. On February 2, 2007, Yeh filed a motion to allow her claim  
14 as a late claim.

15 On February 14, 2007, Yeh filed an adversary proceeding seeking  
16 to revoke the order confirming the Plan and seeking a determination  
17 that her claim was not dischargeable: i.e., A.P. No. 07-4032 AT (the  
18 "Adversary Proceeding"). A hearing was conducted on the Trustee's  
19 objection to Yeh's claim. At that time, the Court found that the  
20 claim was untimely and that the law did not permit the filing of a  
21 late claim in a chapter 13 case. The Court confirmed the Plan  
22 without prejudice to a determination that Yeh would not be bound by  
23 the Plan if, in the context of the Adversary Proceeding, the Court  
24 determined that Yeh had not received notice of the bankruptcy case in  
25 time to file a claim or an objection to the Plan.  
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1 A trial was conducted in the Adversary Proceeding on February 11  
2 and 12, 2008. At the conclusion of the trial, the Court found that,  
3 prior to the commencement of the bankruptcy case, Yeh advanced a  
4 total of \$564,438 to the debtor Michael Johnson ("Johnson"),  
5 originally as a short term business loan and later to assist him in  
6 obtaining a windfall profit in a scheme in which he had already begun  
7 to invest and that turned out to be a scam. The Court found that  
8 Johnson had promised to share the profits from the scheme with Yeh if  
9 there were any, if not, to repay them what they had advanced to him.<sup>1</sup>  
10 The Court did not believe Johnson's testimony that Yeh had advanced  
11 the money as an independent investor in the scheme. Thus, the Court  
12 found that Johnson owed Yeh a debt in the amount advanced, plus  
13 interest.

14 The Court found that Yeh knew that Johnson filed for bankruptcy  
15 at or near the time that he filed in March of 2006. The Court was  
16 persuaded that the reason that Yeh did not file a claim at that time  
17 was that Johnson told her that, because she was not listed as a  
18 creditor, she would not be affected by the bankruptcy. The Court  
19 found that Johnson warned Yeh not to tell his other creditors about  
20 the bankruptcy. He promised to sell his house and pay Yeh but not  
21 his other creditors. Yeh initially relied on this promise. However,  
22 she became Johnson sold his house and still did not repay her. At  
23 that time, she went to the police, contacted an attorney, and  
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26 <sup>1</sup>The Court held that the claim was not incurred through fraud.  
It was not persuaded that Johnson had no intention of repaying Yeh  
when he borrowed the money.

1 appeared on a television show, exposing Johnson's misconduct. In  
2 response, Johnson amended the Schedules to list Yeh as a disputed  
3 unsecured creditor.

4 Based on these factual findings, the Court held that, because  
5 Yeh had notice of the bankruptcy case in time to file a timely claim  
6 and to object to confirmation of the Plan, she was bound by its  
7 terms. However, the Court held that Johnson's conduct constituted a  
8 fraud on the court as well as on Yeh. It found that Johnson knew at  
9 the time he converted his case from chapter 7 to chapter 13 that he  
10 owed more than \$564,000 to Yeh, bringing his total unsecured debt to  
11 over \$720,000. As applicable to this case, an individual who owes  
12 unsecured debts of \$307,675 or more is not eligible to be a chapter  
13 13 debtor. For this reason, the confirmation order should be revoked  
14 and the case dismissed. The only remaining issue was whether it  
15 should be dismissed with prejudice.

16 Based on its findings, the Court surmised that the case should  
17 be dismissed with prejudice. However, because Yeh did not seek this  
18 relief in the Adversary Proceeding, the Court felt compelled to give  
19 the debtors an opportunity to persuade the Court otherwise.  
20 Accordingly, the Court issued the OSC, directing the debtors to file  
21 any evidence or argument they deemed appropriate opposing this  
22 disposition. The Court indicated that, if it found insufficient  
23 merit in the filing, it might rule on the order to show cause without  
24 further hearing.

1           On March 12, 2008, Johnson filed a memorandum (the "Memorandum")  
2           opposing the OSC.<sup>2</sup> In the Memorandum, Johnson made three arguments,  
3           none of which had any merit. First, Johnson noted that the primary  
4           basis for the Court's finding that he had committed a fraud on the  
5           court was its assumption that, if Yeh's debt had been scheduled, he  
6           would not have qualified as a chapter 13 debtor because his unsecured  
7           debts would have exceeded the debt limits established by 11 U.S.C. §  
8           109(e). He contends that this assumption was in error, because, even  
9           if Yeh had been listed as a creditor in the full amount claimed, her  
10          claim would have been listed as disputed and thus would not have been  
11          included in the calculation of his debts for debt limit purposes.  
12          Johnson is mistaken. Section 109(e) does not exclude from the  
13          calculation of the debt limits "disputed" debts, only contingent or  
14          unliquidated debts. The amount of Yeh's claim was noncontingent and  
15          liquidated.

16          Second, Johnson contends that, if a court does not confirm a  
17          chapter 13 plan (or vacates an order confirming it), it can only  
18          dismiss or convert the case. There is no statutory basis for  
19          dismissing it with prejudice. In support of this contention, he  
20          cites a 1981 bankruptcy court case from Illinois. More relevant to  
21          this issue is In re Leavitt, 171 F.3d 1219 (9th Cir. 1999), affirming  
22          this Court's dismissal of a chapter 13 case with prejudice on the  
23          basis of the debtor's fraudulent conduct. See also In re Marrama,

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25               <sup>2</sup>The Memorandum stated that the debtors had finalized a  
26               divorce and that counsel representing the debtors at trial no  
              longer represented Mrs. Johnson. Thus, the Memorandum was filed  
              only on behalf of Mr. Johnson.

1 127 S.Ct. 1105, 1112 (2007)(bankruptcy court may, under either § 105  
2 or its inherent powers, issue appropriate sanctions in response to  
3 "abusive litigation practices")

4 Finally, Johnson notes that, because the Court determined that  
5 Yeh had notice of the bankruptcy in time to file a claim and that the  
6 claim was dischargeable, Yeh is not a creditor and has no standing to  
7 seek dismissal with prejudice. Johnson's final argument ignores the  
8 fact that at issue at present is the Court's order to show cause, not  
9 any relief sought by Yeh. The Court concludes that Johnson's conduct  
10 in failing to list Yeh as a creditor by persuading her she would be  
11 paid outside the bankruptcy in preference to other creditors was a  
12 fraud on the court. Thus, the appropriateness of a dismissal of the  
13 case with prejudice does not turn on Yeh's standing as a creditor.

14 Based on the foregoing, it is hereby

15 ORDERED that the above-captioned case be, and it hereby is  
16 dismissed with prejudice.

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